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Paying Income Tax from Trading

It is well known that the IRD have comprehensive powers to request information for the purposes of enforcing the collection of tax. A recent project by the IRD saw those powers directed at identification of on-line traders (using auction websites such as TradeMe) who collectively had not paid over \$1.2 Million of tax over the past three years.



The IRD website advises that as a “general guide”, business income from trading online should be declared (and taxed) if:

- the goods were acquired for the purpose of on-selling,
- the purpose of the activity is to make a profit, or
- the business involves dealing in these goods.

It is important to note that, despite the fact that the IRD’s message is specifically in the context of on-line trading, the same principles can be applied to all types of trading activities.

Irrespective of what a person is doing, whether it is on-line or otherwise, the IRD is likely to apply one of two criteria, namely:

- have goods been purchased with a purpose of resale, or
- does the level of activity indicate that a business exists.

If either criterion applies all profits from the trading are taxable.

In order to determine “purpose”, the IRD is likely to rely on documentary evidence. Without evidence it becomes an argument over a person’s intention, which is difficult to establish at the best of times. If a person does not have a purpose of resale

the IRD could instead argue that a business exists, which case law has shown can be proven on the facts of a particular case. As stated in the Court of Appeal decision of *Grieve v Commissioner of Inland Revenue* in 1984, "whether a business existed turned on the intention of the taxpayer as evidenced by his conduct".

In the *Grieve* case the taxpayers had to prove that their farming activities were a business in the 1976 and 1977 income years, even though it had been operating at a loss. The result was a thorough analysis of what, in the context of the Income Tax Act, is meant by the term "business". The tests arrived at by the Court are:

- statements by the taxpayer as to intention
- the nature of the activity
- the period over which the activity is engaged
- the scale of operations and the volume of transactions
- the commitment of time, money and effort
- the pattern of activity
- the financial results
- whether the activity is run in the same way as other businesses in that particular trade

It is better to consider the tests above, reach your own conclusion and gather evidence that a business exists, before the IRD come knocking on your door.

GST Increase – Be Prepared

As a business owner/operator it is worth taking the time to consider what effect a GST increase will have and what planning can be done to minimise any disruption.



The change in the GST rate should be considered from various angles. There is the mechanical aspect, i.e. the methodology of preparing and filing a GST return through the "change" period. Also, the behavioural aspect, such as, will the rate increase affect patterns of supplier and customer behaviour? Finally, there are other points, including cash flow issues, that will be helpful to keep in mind. The following looks into these various aspects.

If a GST rate increase comes into effect part way through a business's GST period, two GST returns have to be completed. For example, with the rate increase expected to be effective from 1 October 2010, a GST return that ordinarily covers the two month period ending 31 October 2010, will need one GST return for the month to 30 September and another for the month to 31 October.

The process of transitioning to the new rate varies depending on whether a person is on the payments or invoice basis.

Payments basis - debtors and creditors existing at the time of the change are subject to a notional 2.5% conversion and then all payments or receipts are subject to 15%. The notional conversion has the effect of deeming payments or receipts relating to transactions prior to the rate increase to be at a net 12.5%.

Invoice basis – the transition process for those working on an invoice basis may be more

complicated. Most accounting packages are set up with a default GST rate of 12.5%. However, in various circumstances an accounting package will need to simultaneously cater for GST at 15% and 12.5%. For example:

- Purchases subject to GST at 12.5% may be claimed after the rate increase, along with other purchases that are subject to GST at 15%, or
- Credit and debit notes need to be issued or are received at the old rate because of when the original supply took place.

As this transition process is potentially complex, it is advisable to seek guidance from an accountant so that it is navigated correctly.

Systems set up to automatically code repeat transactions will need to be reviewed or switched to manual coding during the transitional period. If an accountant is completing the GST return(s), the client will need to specify which rate applies to every transaction, especially in the periods immediately after the change.

It is likely that businesses will experience an increase in sales to consumers prior to the increase coming into effect. This increase in activity could be in the form of purchases, purchase arrangements where the old rate is "locked-in" or the pre-payment of recurring expenses. Where possible steps should be taken to meet, or take advantage of this demand.

Other points to keep in mind include:

- Reviewing contracts with suppliers and customers to confirm that the effects of the rate change will be neutral. Generally, the GST Act deems a contract to be altered to align with a GST rate change, unless the contract specifies otherwise, or the contract is

entered into more than three months after the rate increase.

- Increasing the amount of a deposit when selling large value assets to avoid having to fund the GST output liability to the IRD prior to full payment being received.
- The increase from 12.5% to 15% represents a 20% impact on cash flow when waiting for a

GST refund to be released by the IRD.

As it is widely anticipated that the change to the GST rate will take place later this year, planning should be undertaken now to determine if your business and your GST return process are properly geared up for the transition and new GST rate. It may be helpful to consult an accountant to enable a smooth transition.

Approaches to Income Tax Matters

There are many varied ways in which income tax can be viewed, including simply regarding tax as an inevitable consequence arising from operating a successful business.

However a realistic approach to take is that along with such factors as labour, finances, livestock etc, tax is just one more element that needs to be managed.

Where, in the case of farmers, change factors including climatic conditions, commodity prices, exchange rate, shortage of killing space at the meatworks etc, are outside the control of the taxpayer, management of taxable income and the consequential tax can be quite difficult.

Fortunately there are some tax provisions that can be applied after the end of the income year,

and these provisions are mechanisms that enable tax saving techniques to be used as a valid part of every tax planner's toolkit. Two useful examples of this are the Income Equalisation Scheme to defer tax liability, and keeping the livestock valuation method under review from year to year.

A further course of action that usually brings beneficial tax outcomes is the carrying out of an estimate of taxable income and the expected income tax situation, in the two or three months preceding balance date.

When considering the best approach to tax matters therefore, there is no substitute for proper tax planning, management and control, and taking advantage of all tax planning techniques that are available to us.

Cropping

The growing of crop types, such as maize, has increased in popularity over recent years, when droughts have reduced livestock numbers, enabling surplus land to be used for cropping.

To take advantage of spring growth conditions, and depending on the crop type, land preparation and planting usually takes place in the spring.

Crops are harvested during mid to late summer, with the plant stalks being baled, eaten by livestock or burned. The ground is then put back into pasture in autumn to feed stock over winter.



Farmers are paid according to the quality and weight of the harvested crop. The quality and weight of the crop are affected by soil fertility, weather, rainfall, planting technique and insect control.

Income from cropping must be brought to account for tax purposes when the crop is "severed from the land".

While cropping requires less labour input than other forms of farming, crops require fertilising, weed and pest control, and sometimes irrigation.

It is important that good accounting records are kept of cropping income and expenses, ideally to distinguish them from other forms of farm income and expenditure.

Crops, such as turnips, planted with the intention of feeding the farmer's own stock are classed as "stock feed". These crops are typically grazed instead of being harvested, therefore requiring no recording of crop income, but just the recording of the expenditure of growing the crop.

Soil Testing

With fertiliser becoming increasingly more expensive, soil and herbage testing is now encouraged as an integral part of the

management of the annual farm fertiliser process. Once the soil nutrient levels are known, mineral deficiencies and plant health can be

targeted by altering the type and quantity of fertiliser.

Soil testing involves soil samples being taken from different areas of a farm, to establish the different nutrient reserves in the soil. Herbage testing involves testing plant materials to show what nutrients the plant has actually taken up, and is a more direct measure of available nutrients in the soil. Some plants are more sensitive to trace elements than others, with grasses being tested for nitrogen, and clovers for phosphorus, sulphur and magnesium.

Soil tests may be included free as part of the

fertiliser package, or may be charged separately. Costs vary depending on the scale of the test and the number of elements being tested for.

Typically costs will be around \$50 for a standard soil analysis, and around \$80 for a standard pasture analysis. Some farmers might have a number of soil and pasture analyses done, so the cost would be several hundred dollars.

The cost of soil and herbage testing is normally accounted for as part of the overall fertiliser cost, along with the actual fertiliser purchase, freight and application costs.

Livestock Tallies

It is extremely important, for the purposes of completing accurate livestock valuations and financial statements, that accurate year end tallies of livestock are taken at balance date.



The annual client checklist sets out all classes and types of livestock.

It is important that the livestock count is done at balance date, bringing to account all livestock at all locations.

Livestock drafted to the meatworks on or around balance date are excluded from the livestock count, the "kill date" being the point at which the livestock are no longer "on hand".

Care taken in recording livestock numbers will always bring beneficial results when accounting and taxation records are prepared.

Snippets

IRD Recording Interviews

The IRD is increasingly conducting interviews using audio recording technology, and has recently sought feedback on its Standard Practice Statement (SPS) for recording interviews with taxpayers.



It is important to note that most interviews are voluntary. The only exception is a compulsory interview under section 19 of the Tax Administration Act (provision for the IRD to require a person to give evidence). These are always electronically recorded, using video recording technology in appropriate cases, and the interviewee's consent is not required. However, attendance by the taxpayer at initial investigation meetings and follow up meetings is generally voluntary in nature.

Excluding section 19 interviews, a taxpayer will be asked before the interview if they consent to the interview being recorded. The taxpayer has the right under the Privacy Act 1993 to not consent to the interview being recorded. The reasons behind the refusal are not important and the taxpayer is not required to justify their

decision to refuse. The draft SPS advises that the IRD will respect the taxpayer's decisions.

KiwiSaver and Business Transfers

On the sale of a business from one company to another, or when companies amalgamate, existing employees are often employed by either the purchasing or amalgamated company. Typically, automatic enrolment into KiwiSaver occurs on commencement of new employment. However, this type of situation is excluded from being treated as "new employment" for KiwiSaver purposes.

Specifically, "new employment" does not include situations where the employee remains on the same payroll or where an employer carries on the "same business", as long as the employee was previously employed on that payroll or in that business. The "same business" is defined as a business that in substance carries on the same or a similar role and includes an amalgamated company or a business taken over as a going concern.

If you have any questions about the newsletter items, please contact us, we are here to help